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No. 83-586

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SHELL PETROLEUM N.V.,

Petitioner,

—against—

MICHAEL FRANCHETTI, KENNETH CORY, WILLIAM M. BENNETT, INDIVIDUALLY AND AS MEMBERS OF, AND GERALD H. GOLDBERG, INDIVIDUALLY AND AS EXECUTIVE OFFICER OF, THE FRANCHISE TAX BOARD, STATE OF CALIFORNIA,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF OF PETITIONER

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Introductory Statement

The brief of respondents ("the Board") in opposition to the petition attempts to confuse a relatively simple question. Petitioner Shell Petroleum N.V. ("SPNV"), a Netherlands company, claims to have standing to invoke the provisions of the Treaty of Friendship, Commerce and Navigation between the United States of America and the Kingdom of The Nether-

lands (the "Netherlands FCN Treaty")[1] to remedy the unique injuries that SPNV itself has sustained as a result of the Board's conduct. As the lower courts have held, SPNV has in fact sustained actual injury from the Board's efforts to combine the income of SPNV and its more than 900 worldwide subsidiaries and affiliates with the income of its United States subsidiaries, Shell Oil Company ("Shell Oil") and Scallop Nuclear Inc. ("Scallop Nuclear"), for purposes of applying California's unitary corporate franchise tax. (Appendix to Petition at 3a, 16a.) The question remaining is whether SPNV falls within the zone of interests to be protected by the Netherlands FCN Treaty. The petition shows that SPNV, a company of The Netherlands, not merely "arguably" but plainly falls within the class to be protected by the Treaty. (Petition at 18-21.) Consequently, under the decisions of this Court, SPNV has standing under the Netherlands FCN Treaty to challenge the Board's efforts to apply California's unitary corporate franchise tax upstream to reach the income of SPNV and its overseas subsidiaries and affiliates. *See Valley Forge Christian College v. Americans United for Separation of Church & State, Inc.*, 454 U.S. 464, 474-75 (1982); *Association of Data Processing Service Organizations, Inc. v. Camp*, 397 U.S. 150, 153 (1970).[2]

Direct Injury to SPNV

Attempting to skirt the result compelled by traditional standing analysis, the Board has argued that SPNV is in reality

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[1] Entered into force December 5, 1957, 8 U.S.T. 2043, T.I.A.S. No. 3942.

[2] SPNV also claims that it has standing to challenge the Board's actions under the Foreign Commerce Clause, U.S. Const. art. I, § 8, cl. 3. California's efforts to reach a foreign parent company such as SPNV inevitably result in substantial double taxation. *See Container Corp. of America v. Franchise Tax Bd.*, 103 S.Ct. 2933, 2959 (1983) (Powell, J., dissenting). This double taxation burden is an injury unique to SPNV (and its parent companies) and furnishes another independent source of standing for SPNV to challenge California's unrelenting effort to apply its unitary taxation law to reach SPNV's assets. (Petition at 21-23 & n. 26.)

only seeking to remedy injuries to Shell Oil and Scallop Nuclear and derivatively to assert the rights of those companies. That is simply not the case.

The reality is that SPNV is seeking to redress injuries sustained *directly by it. First,* the Board has for over eight years attempted to include in the combination, apportionment and taxation process the income of SPNV, as well as the income of its foreign subsidiaries and affiliates.[3] The Board seeks to reach "upstream" from the nominal taxpayers, Shell Oil and Scallop Nuclear, and in economic effect tax hundreds of millions of dollars of income of the Royal Dutch/Shell companies for the years in question—more income, in fact, than the total consolidated income collectively earned everywhere by Shell Oil and Scallop Nuclear for that period, and income which did not accrue to either Shell Oil or Scallop Nuclear. (Petition at 20-21.) *Second,* the asserted tax liability would also effectively result in substantial double taxation that SPNV alone would face. (Petition at 21-22 & n.26.) *Third,* the Board has also effectively imposed substantial and onerous information demands on SPNV; although directed at the nominal taxpayers, the demands ask for information that only SPNV and its other overseas subsidiaries or affiliates can provide. The Board has coerced SPNV itself to comply with such demands by imposing multimillion dollar fines on Shell Oil when that company did not produce information it did not possess and could not obtain. (Petition at 23-24.)

SPNV is seeking to assert rights and protections *accorded to SPNV* under the Netherlands FCN Treaty. SPNV is not attempting to raise any treaty or other rights of Shell Oil or Scallop Nuclear. It has invoked the provisions of the Treaty that expressly protect companies of The Netherlands engaged in trade or other gainful pursuit in the United States, directly or "through the medium of any form of lawful juridical entity".

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[3] Contrary to the Board's apparent assertion (Respondents' Brief at 6 n.4, 17), the record is clear that the income of SPNV, as well as its more than 900 overseas subsidiaries and affiliates, is included in the Notices of Proposed Assessment issued by the Board. (Heeneman Aff. ¶ 9; McCutcheon Aff. ¶ 2; Kennedy Aff. ¶¶9 & 11.)

Art. VII, ¶ 1. Similarly, SPNV is seeking to invoke *its own right* under the Foreign Commerce Clause of the United States Constitution to be free from the double taxation that inevitably flows from the Board's efforts to impose its unitary tax upstream.[4] While it is true that both Shell Oil and Scallop Nuclear are also adversely affected by the Board's unrelenting effort to impose California's corporate franchise tax on a worldwide unitary basis, the Board's effort has uniquely affected and injured SPNV.[5]

The fallacious assumption by the Board and the lower courts that SPNV is seeking to invoke the legal rights of its subsidiaries has led to a complete misreading of this Court's opinion in *Sumitomo Shoji America, Inc. v. Avagliano,* 457 U.S. 176 (1982). That case held that a United States subsidiary was not a "company of Japan" for purposes of the Japanese FCN Treaty; it dealt with neither the rights of a foreign parent company under the Treaty, *id.* at 189-90 n.19, nor the substantive protections of the Treaty. Whatever effect *Sumitomo* might have on the rights of Shell Oil and Scallop Nuclear to invoke the taxation provisions of the Netherlands FCN Treaty, that decision does not preclude SPNV from asserting rights accorded by the Treaty *to SPNV* as a company of The Netherlands.

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[4] *See supra* n.2. The Board does not respond to SPNV's claims under the Foreign Commerce Clause. Rather, the Board attempts to mischaracterize SPNV's arguments as being based on the Due Process Clause. (Respondents' Brief at 21.) While it is true that the Due Process Clause may well be offended by the level of actual taxation arising from the Board's unitary position, SPNV has clearly grounded its double taxation arguments on the Foreign Commerce Clause. (Petition at 21-23.)

[5] Notwithstanding the Board's effort to mischaracterize SPNV's position, SPNV does not argue that shareholders of a corporation may bring a direct action for injury to the corporation. Rather, SPNV has argued that it has sustained unique injuries different from those to the corporation (and all other shareholders) and thus has standing to seek redress for those injuries independent of the corporation. *See, e.g., American Power & Light Co. v. S.E.C.,* 325 U.S. 385, 389-91 (1945); *Harmsen v. Smith,* 542 F.2d 496, 500-01 (9th Cir. 1976); *Empire Life Ins. Co. v. Valdak Corp.,* 468 F.2d 330, 335 (5th Cir. 1972).

Effect on Treaties

The Board's brief also fails to face up to the ultimate impact the decision below would have if it is allowed to stand. The decision of the Court of Appeals has in effect read out of the Netherlands FCN Treaty all protections for companies of The Netherlands save the right to national treatment. Unless reversed, that radical limitation on the substance of the Treaty will necessarily have the effect of eviscerating all 21 of the treaties of Friendship, Commerce and Navigation entered into by the United States after World War II. The adverse international ramifications of the lower court's ruling cannot be overstated.

The issues in this case are deemed of great importance by major trading partners of this country. Not only has the government of The Netherlands filed a brief *amicus curiae* with this Court in support of SPNV, but the governments of all ten countries of the European Communities—Belgium, Denmark, France, the Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands and the United Kingdom—have sought leave to file a brief *amici curiae* urging this Court to grant SPNV's petition.[6] That action is to our knowledge without precedent. In any government there is a natural reluctance to become involved in judicial proceedings in other countries. That not one, but ten, governments are moved to take that step in this case is strong support for SPNV's position that the impact on foreign commerce and international relations of the lower court's misinterpretation of the Netherlands FCN Treaty requires prompt judicial resolution of the issues presented.[7]

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[6] It became necessary for the ten countries of the European Communities to seek leave of this Court to present their views in this matter because the Board refused to consent to such filing.

[7] The references by the Board in its brief to the Working Group chaired by the Secretary of the Treasury, Donald T. Regan, are interesting in that they reflect that the United States government recognizes that the use of the worldwide unitary method of taxation presents a domestic political problem that must be addressed. Nevertheless, the establishment of that Working Group does not touch on

The Board also purports to state the views of the Federal government on the meaning of Article XI, ¶ 4 of the Netherlands FCN Treaty as it relates to the question of standing. (Respondents' Brief at 16-18, 28-29.) SPNV has amply demonstrated in the record below the documentary support for its interpretation of Article XI, ¶ 4 (*see, e.g.*, Milton Aff. Exs. 1-8; Appendix to Memorandum in Support of Plaintiff's Motion for Summary Judgment; Sherfy Aff. ¶¶ 3-5), and that view is fully supported by the government of the Kingdom of The Netherlands, one of the two signatories to that Treaty. (*See, e.g.*, Memorandum *Amicus Curiae* of the Kingdom of the Netherlands (filed in district court) at 8-37; Supplemental Memorandum of the Kingdom of the Netherlands (filed in district court) at 1-8.) Any doubt as to the Federal government's position on whether SPNV is within the zone of interests of the Netherlands FCN Treaty can be resolved by inviting the views of the Solicitor General—something the Board apparently fears. (Respondents' Brief at 29 n.31.)[8]

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the issues of SPNV's standing or the ripeness of its claim, which are the matters squarely before this Court. Moreover, the Working Group does not address (nor is it competent to do so) the basic issue underlying this case, that is, whether the upstream imposition by a state of unitary taxation on a worldwide basis on United States subsidiaries and their foreign parents violates applicable existing FCN treaties or the United States Constitution. Indeed, the issues to be considered by the Working Group as set forth in the Fact Sheet attached as Appendix A to the Board's brief do not include or refer to that basic issue.

[8] The Board argues that SPNV's interpretation of the Treaty cannot be correct because it is "inconceivable" the Federal government would "surrender its right" to tax Shell Oil and Scallop Nuclear as domestic corporations on their "total income". (Respondents' Brief at 18.) The simple fact is that SPNV's interpretation does not require any such "surrender". The Federal government already taxes both Shell Oil and Scallop Nuclear on their income "from whatever source derived", 26 U.S.C. § 61 (1967), and the Federal government does not—and cannot—engage in that taxation by upward combination with and apportionment of the income of SPNV and its worldwide affiliates. *See, e.g.*, 26 U.S.C. § 482 (1978); Convention between the United States of America and the Kingdom of The Netherlands with Respect to Taxes on Income and Certain Other Taxes, entered into force December 1, 1948, 62 Stat. 1757, T.I.A.S. No. 1855, as amended by the Supplementary Convention, entered into force July 8, 1966, 17 U.S.T. 896, T.I.A.S. No. 6051, Art. II, ¶ 1(i)(A) & (F); Art. III, ¶¶ 1 & 2.

Ripeness

The issues raised by SPNV in this case are whether the application by California of unitary taxation to the income of SPNV and its foreign subsidiaries and affiliates violates the rights of SPNV under the Netherlands FCN Treaty and the United States Constitution. Hypothetical future adjustment by the Board of figures or amounts with respect to particular items or claims relating to the taxation of Shell Oil and Scallop Nuclear (or, for that matter, the taxation of any other United States subsidiary of a foreign parent) does not affect in the slightest the basic issue of whether the Board has the legal right to impose unitary taxation on an upstream worldwide basis on a United States subsidiary and its foreign parent. The Board has for eight years maintained and continues to maintain that it has such a legal right,[9] despite the provisions of the Netherlands FCN Treaty and the Constitution.

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[9] The Board has argued that Shell Oil's refusal to extend the statute of limitations forced its hand and that, therefore, it had to issue Notices of Proposed Assessment ("NPAs") to Shell Oil. (Respondents' Brief at 23.) What the Board fails to explain is why Shell Oil was obligated to extend the statute of limitations and provide the Board with further excuses for the Board's dilatory behavior.

The Board attempts to portray a flexible position on the part of the Board and a fluid state of affairs between the Board and Shell Oil. (Respondents' Brief at 7-8, 23-24.) In point of fact, the Board has remained adamant for over eight years on treating Shell Oil, Scallop Nuclear and all other Royal Dutch/Shell companies as unitary, even though all information available to Shell Oil responsive to the Board's questionnaire has been provided and no further questions concerning the business relations of Shell Oil and other Royal Dutch/Shell companies for the tax years in question have been posed by the Board. (Petition at 28 n. 34; Kennedy Supp. Aff. ¶ 11.) The Board cites to a conference with representatives of Shell Oil in August 1981 (Respondents' Brief at 7), yet in the intervening two years there have been no new NPAs or any other concrete shift in the Board's position.

The simple fact is that the Board has issued NPAs to Shell Oil and determined and communicated to Shell Oil and Scallop Nuclear the amount of back taxes each company allegedly owes. Thus, a concrete amount of money is at stake in the litigation, an amount that will not be significantly altered, if at all, unless in a truly astounding about-face the Board suddenly changes its position of over eight years that upstream unitary taxation is appropriate.

The injury to SPNV from postponing judicial review of this case is apparent. The Board's actions have effectively placed SPNV on the horns of a dilemma that can only be alleviated by prompt adjudication of the treaty and constitutional issues at stake. Either SPNV can stand on its rights not to comply with the Board's burdensome and extraterritorial information demands, and run the proven risk of seeing enormous penalties imposed upon its subsidiaries, or it can comply with the information demands at tremendous expense and be forced to abandon its rights under the Netherlands FCN Treaty and the United States Constitution not to furnish such information. Since the legal issues raised by the Board's assertion of a right to impose worldwide unitary taxation upon SPNV and its subsidiaries and affiliates will in no way be affected by further administrative proceedings in California, and only substantial harm to SPNV can result from delayed adjudication of those legal issues, this case is surely ripe for judicial review. *See Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission,* 103 S. Ct. 1713, 1720-22 (1983); *Abbott Laboratories v. Gardner,* 387 U.S. 136, 148-49 (1967).[10]

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[10] The Board has devoted a large portion of its brief to reciting its view of "facts" that are largely irrelevant. SPNV will not address those factual assertions except to point out that the Board has presented *its* interpretation and SPNV has refuted that interpretation. SPNV respectfully refers the Court to the affidavits filed by SPNV in the district court.

Conclusion

The Board's attack on standing and ripeness is merely a device to prevent the challenge asserted by SPNV from ever being heard. If this Court accepts those arguments, Shell Oil and Scallop Nuclear will be forced to proceed with California state administrative and judicial proceedings in which SPNV cannot participate. The Board has already announced its intention to seek to deny Shell Oil and Scallop Nuclear the right to raise the treaty rights relied on by SPNV in those proceedings, asserting that Shell Oil and Scallop Nuclear are not companies of The Netherlands protected by the Treaty. Thus, a denial of certiorari by this Court will not only deny SPNV any forum in which it may assert its own treaty rights, but may well deprive SPNV entirely of any adjudication and enforcement of its rights under the Netherlands FCN Treaty.

The Board has devoted a large portion of its brief to arguing the merits of SPNV's claims under the Netherlands FCN Treaty. This focus on the merits demonstrates that purely legal issues are present in this case, issues that are ripe for adjudication. It is clear even from the Board's brief that the decision of the lower court is far too simplistic an evaluation of the Treaty to be allowed to stand. Moreover, nine sovereign nations have expressed to this Court their concern that the decision of the court below is seriously at odds with their own interpretation of their FCN treaties with the United States. It is thus apparent that this petition presents novel and important questions of Federal law requiring this Court's attention.

For the reasons set forth above and in SPNV's petition, the petition for a writ of certiorari should be granted.

November 25, 1983

Respectfully submitted,

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